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RECOMMENDATIONS FOR IMPROVEMENT IN AUDIT QUALITY - CORPORATIONS LEGISLATION AMENDMENT (AUDIT ENHANCEMENT) BILL 2012

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ABSTRACT

The audits are a tool that helps businesses gauge their performance against the objectives set for them by themselves, the governments, societies, communities, organizations and other relevant stakeholders. It is not only a mechanism to identify 'compliance' or 'non-compliance' but a measure to drive long-term continuous improvement in business processes. Accordingly, governments around the world, including Australia, set certain quality assurance criteria and governance principles around the auditing process in line with the relevant national objectives and productivity goals. To keep up with the changing times and newer dimension in the field, these legislations, codes of practices, guidance notes, standards and recommendations are reviewed and amended time to time. With each new amendment or change, it is important to analyse and present the value it brings to the processes so that auditors and auditees can understand the benefit it carries for them. Current paper is an attempt to present an overview of changes brought forth by Corporations Legislation Amendment Bill of 2012 (Australia).

INTRODUCTION

The Corporations Legislation Amendment (Audit Enhancement) Bill 2012, an outcome of extensive Treasury review and engagement of stakeholders in consultative processes, provides framework to ensure optimization of Australian Audit standards and alignment with international best practices. Following is a brief discussion on important recommendations regarding improvement of audit quality as mentioned in the bill:

PUBLISHING OF ANNUAL TRANSPARENCY REPORT:

Annual transparency reports are required to be published by large auditing companies who are engaged in auditing of 10 or more significant entities as per section 32 of the Bill. This reporting mechanism is put in place to ensure that auditors make all possible efforts to ensure transparency in their processes. This also encourages public feedback, criticism and analysis which brings process improvement and accordingly, auditing standards improve as a result. Another benefit from this is the infusion of positive competition between the major players who take reasonably good measures for improving audit quality and transparency to out-class their competitors. Such procedures serve as a guideline for emerging auditors. Usual contents of Annual Transparency Reports include:

- 'Description of auditor's top management commitment to quality and transparency',
- 'Audit quality assurance procedures, systems and practices',
- 'Explanation about the relevant organizational structure to support effective auditing process',
- 'Review of audit expertise with the firm, qualification and background of auditors',

- ‘Details of performance against their audit KPIs’,
- ‘Guidelines to assist audit committees in the evaluation of audit quality’ and
- ‘Statement showing compliance with legislative requirements and relevant auditing standards’.

Section 332B of the Bill provides details about contents of such reports. However, certain information can be removed from the report in case there is a chance of biasness about the auditor due to such information and note should be made in the report accordingly. In our opinion, this measure will bring great improvement in the overall functioning and effectiveness of auditing firms.

EMPOWERMENT TO ISSUE AUDIT DEFICIENCY REPORT:

As per section 50B and C of the Corporations Legislation Amendment (Audit Enhancement) Bill 2012, ASIC (Australian Securities and Exchange Commission) has been given the powers to issue ‘Audit Deficiency Report’ to certain Australian auditing firms. Commonly found audit deficiencies include:

- Non-compliance with ‘audit standards’,
- ‘Auditor independence requirements (as specified in the Section 324CE of Corporations Act 2001)’,
- ‘Relevant code of professional conduct’ and
- ‘Legal provisions regarding the conduct of audit’ or
- The matters about which ASIC is convinced that there are reasonable deficiencies with regards to auditor's quality control system or
- The matters demonstrating that the conduct of the audit negatively impacted the audit quality.

ASIC evaluates such gaps through a comprehensive assessment system operating under the umbrella of their ‘Audit inspection and surveillance programs’ and other relevant initiatives. Audit deficiencies, as explained above, determined by ASIC have to be communicated to auditor along-with any recommendations for improvement to which he is required to respond within six months with all relevant details in accordance with Section 50B of the Bill.

If ASIC is convinced that the reasonably practicable measures have not been taken, it can issue the Audit Deficiency Report as specified by section 50C of the Bill which may be published under certain conditions after appropriate consultation with stakeholders. In our opinion, this action will help establish strong control on organizations regarding audit quality and meeting required auditing standards.

REMOVAL OF DUPLICATION OF RESPONSIBILITIES BETWEEN ASIC AND FRC:

Duplication of responsibilities adversely affects the performance of entities. Considering this fact, current bill segregates the responsibilities of ASIC and FRC (Financial Reporting Commission) and removes duplication in operational activities regarding audit independence. The latter is required to gather relevant information only from the professional accounting bodies and its audit independence function is removed [1]. It is replaced by additional responsibility and focus regarding strategic policy advisory and audit quality reporting to the concerned minister and accounting

bodies. ASIC, after the passing of this bill, is the only responsible body to carry powers regarding Audit Independence. There is a framework for information sharing between ASIC and FRC which would continue to enable them collect required information without the duplication of responsibilities [2]. This measure is expected to bring uniformity in audit inspection procedures, clarity in communication and well-defined structure for responsibility and assurance.

ASIC TO DIRECTLY COMMUNICATE WITH AUDITED BODY:

In the subject Bill, ASIC has been given the authority to directly contact the audited bodies and their audit committees and communicate with them regarding any matters deemed necessary to be discussed with them during the performance of ASIC's statutory responsibilities. ASIC was previously not allowed to communicate with audited bodies directly due to confidentiality reasons. However, ASIC felt a need for empowerment to communicate as they, at times, were able to identify inappropriateness in audit conduct or relevant practices of the audit firm (through there audit inspection and surveillance programs) which they are unable to disclose to the audited body without the Audit firms consent in accordance with Division 2, Section 127, ASIC Act 2001 dealing with confidentiality requirements. These amendments have removed this restriction and ASIC will be able to get in contact with responsible persons in the audited body with regards to disclosure of relevant information. However, it should not disclose how a particular audit was done unless the auditor is notified at least seven days in advance. Joint Accounting bodies, who have contributed to the development of relevant auditing legislation by liaising with treasury and providing their useful inputs, have expressed their opinion that the preferred solution to deal with such cases would be to compel Auditing companies to informed audit bodies of any discrepancies in audit process, procedures or conduct and ASIC should not get involved in the process itself [3]. In our opinion, detailed pros and cons of both the approaches have to be identified in a forum providing due representation to all the stakeholders including major players from the audited bodies of various natures, major auditing companies, ASIC and others. This committee should make recommendations which are in the greatest interest of Australian businesses and economic stability.

2-YEAR EXTENSION TO THE 5-YEAR AUDITOR ROTATION REQUIREMENT

Auditor rotation requirement has been in place to ensure independence of audit function and necessitates that a particular auditor should not be involved significantly in an entity audit process for more than 5 out of 7 successive financial years [4]. It is obvious that an auditor gains more insights and experience while performing same or similar audit activity repeatedly and efficiency, depth and breadth of the audit accordingly increases. However, when the auditor is rotated, it is not unexpected that the new auditor would take settling in time. Audit firms take a variety of measures to avoid void for information due to rotations by establishing well-defined rotation schedules where lead and review auditors change at different intervals. However, there were concerns regarding this issue from more complex businesses where in-house information acquired over a period of time is of particularly high value. Current bill proposed extension of up to 2 years for the 5 year auditor rotation requirement if deemed necessary by responsible authorities or audit committees of listed entity and found beneficial for audit quality improvement through the retention of knowledge and experience without any conflict of interest situation or compromise on audit independence and objectivity. Recommendations for this increase in duration from audit committee should be in the

form of in-writing formal resolution, however, it is upon the discretion of directors to accept or reject this recommendation. This approach has certain benefits for auditing companies too [5]. This includes effective performance in auditing and reduction of cost implications associated with audit process. The possible risk with this approach is the chances of existence of common interest between the auditor and the audited entity due to a longer relationship for which adequate control measures shall have to be put in place. The joint accounting bodies [6] and FRC's Audit Quality Task Force [7] support this recommendation.

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